



JUST MEMORIES Ernest Minor faces losing his home after a reverse mortgage came due following the death of his wife, Norma.

Reversals of fortune

The next financial fiasco? It could be reverse mortgages.

ERNEST MINOR IS PACKING UP his Marysville, Calif., home. After his wife, Norma, died in 2007, a reverse mortgage came due—a whopping bill of more than \$200,000. (The home's current value is \$130,000.) Now Minor, who says he was misled into thinking the loan was a good way to pay for Norma's mounting medical bills, is likely to be evicted.

Reverse mortgages can be valuable as a last resort for seniors who want to stay in their homes and have significant equity but need money to supplement income or banish an existing mortgage payment. With a reverse mortgage, they can trade some of that equity for a lump sum and monthly payouts.

But those loans can be terrible for customers who don't understand the compli-

cated rules governing them and how quickly high fees and interest charges can balloon. They can end up stranded in their homes without any remaining equity to cover unexpected costs later in life.

Use of the loans is exploding as lenders—who shoulder almost no risks—push them to the growing ranks of retired baby boomers, especially for spending on vacations, new cars, and more.

Lawmakers and regulators are getting worried. "The people who are making these loans and advertising them so heavily to seniors on cable TV get the rewards but escape the risks that come with them. It's going to be the sequel to the subprime-mortgage mess," says Sen. Claire McCaskill, D-Mo., who is pushing for reverse-mortgage industry reforms.

A CONSUMER REPORTS investigation

has found more cause for concern:

- Loan bailouts have soared. The annual sum of reverse mortgages taken over by a federal insurance fund has more than quadrupled in four years, from \$81.3 million in 2004 to \$381.3 million in 2008, according to our analysis of more than 500,000 loans over two decades.

- Taxpayers are being tapped to subsidize reverse mortgages for the first time. Usually, insurance premiums paid by borrowers have covered bailouts of mortgages by the fund. The payouts to lenders occur under certain circumstances, such as when the eventual sale of a borrower's home doesn't cover the money owed on the loan. Now the Department of Housing and Urban Development says that \$798 million in taxpayer money must be budgeted in the next fiscal year to cover

PHOTOGRAPH BY EDWARD CALDWELL

potential losses that won't be covered by the premiums.

- Marketing can be misleading. Too often sales pitches emphasize the positives and play down the high costs of the loans. At a March 2009 industry conference in New York City, one speaker delivered advice on the "10 Commandments for Selling to Seniors," including beginning the pitch with appeals to emotions rather than reason.

- Unsuspecting borrowers have become cash cows for lenders and others who encourage them to use their mortgage proceeds to buy financial products such as deferred annuities that can be inappropriate for their situation. And the required counseling for the mortgages can be far too skimpy.

A different kind of debt

Reverse mortgages started out as a niche product to give cash-strapped seniors supplemental income. The loan allows people 62 and older to cash in some of their home equity and receive a lump sum, regular payments, or a credit line.

Existing mortgages are paid off with a portion of proceeds. Borrowers make no monthly payments. As long as the homeowner keeps the home in good repair and pays property taxes and property insurance, the loan does not have to be repaid until the last borrower dies, sells, or lives elsewhere for 12 consecutive months.

If the market value of the home is less than the loan balance when it comes due, federal insurance compensates the lender for the difference.

For a \$300,000 home in the New York City area, recent lender quotes show that the maximum available up front on the loans, also known as home equity conversion mortgages (HECMs), with a monthly adjustable interest rate was \$152,074 for a 64-year-old borrower or \$182,541 for a 74-year-old.

The fees on a reverse mortgage can add up. That 74-year-old reverse-mortgage borrower living in a \$300,000 house could expect to pay about \$15,000 in up-front costs (insurance premiums, broker's fees, and other closing costs) for the federally backed reverse mortgage plus another \$15,000 over the life of the loan in monthly insurance premiums and servicing fees. That's \$30,000 in fees, or one-sixth the amount borrowed.

Moreover, fees aren't paid up front but

are generally folded into the loan from the start. Most reverse mortgages also have interest rates that are adjustable monthly, and the rate can increase by up to 10 percentage points over the life of the loan. So the borrower is paying interest on the fees and premiums as well as the lump-sum cash or monthly payments.

Since 1990 the FHA insurance fund has backed more than 500,000 reverse mortgages, and growth is expected to continue in 2009. Meanwhile, the lending limits have climbed from \$417,000 to \$625,500.

Now lenders and other financial professionals are trying to broaden the appeal of reverse mortgages to retiring baby boomers, who turn 65 at the rate of about 10,000 per day. They're an alluring target: By 2010, more than 50 million Americans will be 62 or older, and more than 80 percent own their homes, controlling an estimated \$4 trillion in equity.

'Wake up to a whole new life!'

The ads are enticing. "Did you know your

home is a giant piggy bank?" asks a TV commercial for Judith O. Smith Mortgage Group in Fort Worth, Texas. The ad promises that you can pay off debts with tax-free income and that "your family will still inherit your home!" All Reverse Mortgage in Tacoma, Wash., invites seniors to "Wake up to a whole new life!" by using reverse-mortgage money to "Travel or Do Something Special." Ads from Wells Fargo, one of the biggest lenders, encourages seniors to get a reverse mortgage and "Do anything you want with the money."

The marketing blitz is drawing criticism. "Urging consumers to use the equity in their home like an ATM or credit card is a recipe for disaster, which is a lesson you would have thought we already learned all too well," says Chuck Cross, vice president of mortgage regulatory policy for the Conference of State Bank Supervisors.

The loans should be considered as a last resort, not a first resort, as some of the marketing now implies, says David Cotney, chief operating officer of the Massachusetts Division of Banks.

Industry leaders defend the new approach. "The old concept is that reverse mortgages are for financially hard-pressed seniors, often a widow who can't make ends meet on just one income," says Peter Bell, president of the National Reverse Mortgage Lenders Association. He says that although there are still some "need based" reverse-mortgage borrowers, a growing number simply want to eliminate current mortgage payments and boost cash reserves for home and car repairs or to "buy discretionary items like a new TV."

He says an even bigger new market is retirees with substantial assets who can use reverse mortgages to meet cash needs while giving their investment portfolios time to bounce back, which is the theme of recent ads sponsored by MetLife Bank.

Meg Burns, a director at the Federal Housing Administration who helps oversee the reverse-mortgage program, says the mortgages have a vital role to play. "Our primary mission in life is to try to put consumers into safe, affordable financing," she says, "and it is a really good loan product for people who have equity but not income, who have this asset but not sufficient cash flow to live comfortably."

Ad watch



LENDING LURES Commercials equate the equity in your home to a piggy bank, a credit card, or the solution to investment losses.

One couple's story

That was part of the initial appeal to Ernest Minor, now 64. His wife faced multiple medical problems, bills were piling up, and Minor was persuaded by a broker to seek a reverse mortgage. There was only one glitch: At the time, Minor wasn't yet 62, the minimum age for obtaining a federally insured reverse mortgage. He says the broker suggested taking his name off the deed so that the loan would be issued solely to his wife, Norma, who was 68 when the loan closed in late 2005.

"The mortgage broker came to our house with a notary public and his own copying machine so that he could get all of the papers signed right on our kitchen table," Minor says.

After his wife died in 2007, Minor was surprised to receive a letter from Financial Freedom, saying that her death made the mortgage payable and that foreclosure proceedings would begin if he did not refinance or pay off the balance.

"The broker told me my name could be put on the mortgage as soon as I turned 62, but that never happened," Minor says. He says that he and his wife never understood that he risked losing the home. Initially, the couple received about \$70,000 to pay off their previous mortgage and a lump sum of about \$91,700 to cover medical bills, a new roof, and other expenses. But closing costs of almost \$15,000 plus steadily growing finance charges pushed the total payoff amount to more than \$200,000.

According to Minor, the home is now valued at only \$130,000 and he can't find money to pay off the loan. Attempts to negotiate refinancing or some other solution with lenders have been fruitless.

Financial Freedom, in a letter, says it "acknowledges Mr. Minor's unfortunate situation and has repeatedly delayed foreclosure—which is required under HUD guidelines—for almost two years since his wife's passing to allow Mr. Minor time to find a solution."

HUD warns against removing a homeowner's name from a home's deed.

Taxpayers are on the hook

No matter how much the banks lend, the transaction is almost risk-free for them because it is guaranteed by the federal government through the insurance fund.

That insurance comes into play in certain situations, including when a loan goes into foreclosure after the death of a borrower with no heirs or when a borrow-

er fails to pay taxes and insurance on the property. It also can occur if the proceeds from the sale of the house won't cover the balance owed, as is often the case with declining home values. Together, those two categories of lenders' claims against the federal insurance fund have grown to a cumulative total of \$109.4 million from late 1993 through May of this year.

But an even bigger source of claims on the insurance fund is loans that have neared their limit. The bank can be reimbursed by the insurance fund once the balance owed on the mortgage reaches 98 percent of the loan's maximum lending limit, a dollar amount set at the time the mortgage is approved. The FHA then pays the lender

Officials worry about potentially big loan liability.

98 percent of the loan and takes on responsibility for servicing the loan as long as the borrower lives at the property. Just how many of those claims will result in insurance-fund losses won't be known until those homes are sold.

As more reverse-mortgage balances hit that 98 percent figure, that category of claim payouts to lenders is now by far the largest, totaling more than \$1.36 billion by May 2009, up from \$128.753 in late 1993.

Claims by lenders vary markedly, our study shows. One of the biggest lenders, Wells Fargo, sought or issued claims for 2 percent of the 115,075 loans it generated. But that figure was 25.1 percent for Ameri-

First Mortgage Corp., which issued 1,856 mortgages, primarily in the Northeast. Part of the reason could be that AmeriFirst issued its loans in the early years of the program and none in recent years. As loans age, there is a growing likelihood they will tap the insurance fund, adding to the concerns about the program's future.

But there's also a worrisome trend among newer loans, according to our study. Although the numbers are small, loans issued in 2005 were more than twice as likely to result in a claim on the insurance fund three years later as loans issued in 2002. That suggests that some borrowers might be exhausting their equity sooner than expected and that the government might face the prospect of more bailouts down the road.

Borrowers pay hefty premiums for the federal insurance backing these loans—up to \$6,000 up front plus fees that equal 0.5 percent of the principal amount each year—but lenders reap the benefits.

Until now, income from the insurance premiums that reverse mortgage borrowers pay has more than covered payouts to settle claims, but HUD's request for money is an indication of possible red ink ahead. Burns at the FHA says the growth in claims is simply a shift that reflects the longevity of some loans.

But with almost \$800 million in reserve funds requested, officials are concerned. "We're talking about a huge growth in the potential liability to the American taxpayer," says Sen. McCaskill. She asks, "If this is a good lending tool and a good value for the federal government, then why isn't there a proprietary market

Rising tide of mortgage claims

The dollar amount of claims against the federally run insurance fund for reverse mortgages has risen dramatically in the past few years, according to FHA data.



for reverse mortgages now?"

The insurance-fund claims might also grow as borrowers have trouble paying for the upkeep, property taxes, or insurance on their homes. FHA rules require lenders to take foreclosure action in such cases, but none has done so to date, Burns says. Bell, of the reverse-mortgage lenders association, says the issue has been "a political hot potato" because neither HUD nor the Federal National Mortgage Association (Fannie Mae), which purchases reverse mortgages on the secondary market, wants to "be accused of throwing Grandma out of her house."

Rosy scenarios are misleading

Overly optimistic projections about increasing home values and low interest rates can cause disappointments down the road for families.

"Reverse-mortgage ads promise that seniors will still be able to pass on the equity in their homes to their heirs, but what they fail to mention is that there's a good chance there won't be any equity left," says Prescott Cole, senior staff attorney at California Advocates for Nursing Home Reform.

Case in point: Brett and Cathy Palmer of La Verne, Calif., received a notice from Wilmington Savings Fund Society Bank shortly after Cathy's mother, Joyce Taylor, died in November 2007. The notice stated that the balance was due on Taylor's reverse mortgage. Taylor had taken a total advance of just more than \$77,000 since the loan had been issued in 1993, but fees, interest, and other charges drove up the amount due to about \$588,000.

The Palmers eventually offered to pay \$430,000 to keep the home, but the bank took possession of the property in April 2009. "There's no question that my mother-in-law never would have applied for this loan if she'd realized it could mean the bank would end up with her house instead of us," Brett Palmer says.

Wilmington Savings Fund Society did not originally market the reverse mortgage to Taylor and now only serves as the loan's servicer, says Stephanie A. Heist, a vice president and spokeswoman.

Julia Wysong, coordinator of Financial Abuse Specialist Team, a community-service group in Ventura County, Calif., says, "Loan officers show borrowers an amortization form that projects what the value of the home will be over the next 15 or 20 years. But when they want to make a sale, I've seen them use figures that pres-



HARD SELL Miguel and Laura Posada ended up spending much of their \$100,000 loan on deferred annuities.

ent a misleadingly optimistic picture, such as assuming that your home will appreciate at an annual rate of 8 percent or that your interest rate will remain the same throughout the life of the loan, which is especially unrealistic now when the most likely future direction for adjustable interest rates is up."

The amount of money involved in the loans makes borrowers ripe targets for potentially shady schemes.

Miguel and Laura Posada, both now in their mid-80s, were living comfort-

Lenders are recruiting insurance agents to market loans.

ably in retirement in 2005 near Sacramento, Calif., on pension income and retirement savings in a modest home they owned free and clear. They responded to a direct-mail solicitation from a mortgage broker, who persuaded them to take out a reverse mortgage.

According to their attorney, Mark A. Redmond, the broker, Felix Rivera, was employed by U.S. Financial Mortgage, a lender in Roseville, Calif., and he convinced the Posadas that they needed the

cash from a reverse mortgage to purchase deferred annuities and that he knew an attorney who would "prequalify" them to receive health-care benefits from Medi-Cal, California's Medicaid program.

The Posadas' complaint, which was filed in California Superior Court, states that the annuities paid an interest rate of 3.5 percent, less than the 6 percent interest they were being charged on the reverse mortgage. Though they could withdraw 10 percent of the money invested in the annuities per year, they would not have penalty-free access to the full amount until Miguel was 95 and Laura was 98.

Selling more than loans

According to the complaint, \$20,500 from the mortgage proceeds was paid to Rivera's associate, James A. Walker, a consultant and licensed California attorney. Walker claimed that his plan would ensure that they prequalified for government benefits, including paying the cost of an assisted-living facility if needed. At the time, the California attorney general's office was already investigating Walker concerning his Medi-Cal advising business. Under a 2008 settlement, without admitting guilt, he and his business agreed to change business practices and pay a civil penalty of \$165,000.

The Posadas' lawsuit charges that Rivera and Walker defrauded the couple "by

having them obtain expensive and unnecessary reverse mortgages” for the purpose of paying “grossly excessive fees to fictitiously ‘prequalify’ them for Medi-Cal” and to purchase deferred annuities, which the complaint says are “inappropriate investments for seniors.” Walker’s attorney did not respond to our requests for comment, and we could not locate Rivera.

Recently strengthened federal laws to curb the sale of other financial products along with a reverse mortgage, called cross-selling, haven’t been sufficient to stop the hard-sell tactics. Lenders want to enlist insurance agents because they already have established trusted relationships with the clients that reverse-mortgage lenders want to reach: seniors with significant equity in their homes.

“It’s laughable to think this change in the law will stop anyone from selling a senior a reverse mortgage primarily to get access to money that can generate sales commissions for them through sales of insurance products,” says Neil Granger of Oakland, Calif., who sold life insurance for more than 20 years before becoming a consultant and expert witness on behalf of victims in annuity- and insurance-fraud cases. “A sophisticated agent will just say, ‘Of course you don’t have to buy an annuity with the money you’re getting, but let me show you why I think you should.’”

Hawaii’s insurance commissioner, J.P. Schmidt, says he is investigating 15 cases that have occurred over the past four years in which insurance agents sold seniors reverse mortgages and at the closings gave the borrowers stacks of papers to sign that they didn’t realize included agreements to use some of the mortgage proceeds to purchase high-commission annuities.

Granger says it is not unusual to see \$15,000 to \$20,000 in commissions for a package of a reverse mortgage and some kind of insurance. “It comes out of the client’s pocket whether they realize it or not,” he says.

Despite the law, reverse-mortgage lenders are actively recruiting insurance agents to market their loans, emphasizing the attractive commissions they offer. In a recruiting e-mail recently sent to a licensed insurance agent, reverse-mortgage specialists Senior American Funding Inc. in San Diego proclaims: “We have loan originators making between \$25,000 to \$50,000 a month! We want you to be one of these agents.” Promotional materials urge the

agent to buy a “Reverse Mortgage Success Training Kit” that will demonstrate how to “overcome objections such as ‘The fees are too high’ or ‘I want to think about it.’”

The code of ethics of the National Reverse Mortgage Lenders Association permits cross-selling if lenders meet certain conditions, such as ensuring that the financial products being sold “provide a bona fide advantage” to the customers, though “bona fide advantage” might be open to interpretation.

According to Burns at the FHA, “Saying we don’t want the same company or same person to be selling both products is a worthy goal, but it’s difficult to achieve because how a consumer uses the reverse-mortgage proceeds falls outside of FHA’s jurisdiction, as does oversight of insurance companies, since they’re regulated at the state level.”

Addressing such regulatory issues might be a complex matter, but there is one rule regarding cross-selling that should be very easy to communicate, according to John Lunde, a former executive at Financial Freedom who is now president of Reverse Market Insight, a reverse-mortgage research and advisory firm in Aliso Viejo, Calif. “You should not take the proceeds of a reverse mortgage to purchase any kind of deferred financial product,” he says. “I’ve never seen a situation where that makes sense for anyone other than the salesperson.”

The coming storm

Federally backed reverse mortgages dominate the market now, but some lenders also offer noninsured reverse mortgages aimed at borrowers with high-value homes that exceed FHA lending limits. Unlike government-backed loans, those proprietary reverse mortgages, with some state-law exceptions, have no requirements for independent counseling and no caps on fees or prohibitions against cross selling. Because lenders don’t have the safety net of federal insurance, the cash available to borrowers tends to be proportionally less than with an HECM.

“Even though there aren’t a lot of private reverse mortgage products out here now, they will be coming because there is a lot of money to be made, so we’re very concerned about abusive sales practices coming along with them,” says Cross, of the bank supervisors group.

Federal and state legislators are seeking stronger consumer protections for all types of reverse mortgages. Pending California legislation would extend requirements for beefed-up independent counseling and cross-selling restrictions to mortgage lenders that aren’t federally insured.

Sen. McCaskill has proposed legislation aimed at preventing fraud and requiring that ads for government-backed mortgages present a balanced view of their risks and benefits.

Consumers Union, the nonprofit publisher of CONSUMER REPORTS, believes that sellers of reverse mortgages should be required to make sure the loan is suitable for the borrower and that there should be better restrictions on sales practices. In addition, one-on-one mortgage counseling and fee caps should apply to proprietary mortgages as well as those backed by the federal government.

Jack Christy, director of public policy for Aging Services of California, an association of nonprofit providers of senior housing and services, says, “Baby boomers are going to be skating on thin ice as it is in their retirement years. But this country is going to be in even more trouble if lenders have the green light to just sign them all up for loans that can strip them of their primary nest egg and then stick taxpayers with the bill when it doesn’t work out.”

See “Counseling Is Inadequate” and “Need Cash? Try These Sources First,” on page 40.

DID YOU KNOW?

13,000

Reverse mortgages that resulted in claims to the FHA’s insurance fund in the past 20 years.

\$1.3 BILLION

Total value of those mortgages taken over by the insurance fund.

\$798 MILLION

Amount of taxpayer money requested for fiscal 2010 to secure the insurance fund.

Counseling is inadequate

Counseling is required for seniors considering a federally backed reverse mortgage, but a new federal investigation shows that the sessions are often flawed.

Using undercover investigators, the Government Accountability Office found that counselors did not fully explain the financial implications of getting a reverse mortgage in 14 of 15 cases; in seven cases, they did not discuss alternatives to reverse mortgages, an important requirement.

Under the rules, lenders must provide borrowers with a list of at least five HUD-approved counseling agencies in their state, including one within reasonable driving distance to allow for face-to-face meetings, plus another five that provide counseling by phone nationwide. Depending on the senior's ability to pay, counseling might be free or cost up to \$125.

Len Raymond, founder and director of Homeowner Options for Massachusetts Elders, a nonprofit group that offers free counseling, says, "We get calls from brokers who want to put us on their list to basically become a certificate mill for them. They ask what's the minimum you can do, so when we say we only do in-depth, face-to-face counseling, they aren't interested."

HUD guidelines also require that counselors review borrowers' finances and document a budget based on their monthly expenses, income, total assets, and debts, so that the counselor can evaluate and discuss appropriate alternatives to a reverse mortgage. If you have a problem during a counseling session, try one of the other counselors on your list, preferably one you can meet face to face.

Need cash? Try these sources first.

By using a reverse mortgage in your 60s, you might be unable to pay for home health care or an assisted living facility if you need them later. Consider the following alternatives before opting for a reverse mortgage:

- To supplement income for basic expenses or to meet a specific need, such as home repairs, first investigate other sources of government or nonprofit-agency assistance. Depending on your location, help might include property-tax-relief programs, utility-discount and fuel-assistance programs that pay a portion of winter energy costs, or energy-efficiency improvement programs that offer low- or no-cost energy-efficient appliances.
- Most states have a

government agency to match seniors with local resources and programs to meet their needs. Also check out www.benefitscheckup.org, a screening service that checks older adults' eligibility for various public and private benefit programs in all 50 states and the District of Columbia.

- Draw money from other assets first or consider a home-equity loan or credit line, for which closing costs are a fraction of those for a reverse mortgage.
- If you can't afford to make monthly payments, the best option might be selling your home outright, downsizing, and banking any remaining equity you've accumulated so that you can see it grow rather than diminish over time as it would with a reverse mortgage.